# INDEX



## CITATIONS





516904—43

# In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 766

VIRGINIAN HOTEL CORPORATION OF LYNCHBURG, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 34–38) is unreported. The opinion of the Circuit Court of Appeals (R. 45–52) is not yet reported.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 2, 1943 (R. 53). The petition for a writ of certiorari was filed February 25, 1943. The jurisdiction of this Court is in-

voked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether, in computing depreciation for the year 1938 under Sections 23, 113, and 114 of the Revenue Act of 1938, the taxpayer's basis as of December 31, 1937, should be reduced by the amount deducted for depreciation in prior years in excess of that properly allowable where the excess was not offset by taxable net income for those years.

### STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
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> * * * * *
>
> (l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *
>
> * * * * *
>
> (n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.
>
> * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

The applicable regulations are Articles 23 (l)–1, 2, 4, 5 and 9, 113 (b)–1 and 114–1 of Treasury

Regulations 101, relating to the Revenue Act of 1938.

STATEMENT

The following facts were stipulated (R. 9–17, 22–33) and found by the Board of Tax Appeals (R. 34–38):

The taxpayer is a Virginia corporation which has operated a hotel in Lynchburg, Virginia, since January 1, 1931 (R. 22, 34). In making its returns from that time through the year 1937, it claimed and was allowed depreciation at straight-line rates of 10 percent on all of its equipment except carpets and upon these at 15 percent, based upon an estimated useful life of 10 and 6⅔ years, respectively (R. 25, 37). For the year 1938 the taxpayer claimed a deduction for depreciation at the same rates; but the Commissioner determined that the useful life of the equipment had been underestimated and that the rates of depreciation allowed were excessive. The useful life of the equipment, except carpets, was estimated at 20 years and carpets at 12½ years. From the cost of the property, the depreciation theretofore claimed as a deduction was subtracted, and the remainder was taken as the new base for computing depreciation. As a result, the Commissioner disallowed $3,046.50 of the amount of depreciation claimed by the taxpayer in its return, thus allowing a deduction in the amount of $1,295.47 (R. 10–12, 15–17, 25, 37).

The taxpayer sustained a net loss for the years 1931 to 1936, inclusive, and the entire amount of depreciation deducted in its returns for those years did not serve to reduce taxable income. The year 1937 resulted in a net gain and the depreciation deducted on the income-tax return for that year did serve to reduce taxable income (R. 25, 37).

In the proceedings before the Board of Tax Appeals, the taxpayer did not question the Commissioner's determination as to the new rates for depreciation but it did contend that its base as of December 31, 1937, should include $31,400.25, that being the amount deducted for depreciation in 1931–1936 in excess of that allowable at the new rates. Such inclusion would result in a depreciation allowance of $4,438.14 for 1938 (R. 25–26, 37–38).

The Board of Tax Appeals upheld the taxpayer's contention (R. 38) but the court below reversed (R. 52).

## ARGUMENT

Sections 113 (b) (1) (B) and 114 (a) of the Revenue Act of 1938, *supra,* provide that in determining the basis for depreciation, proper adjustment shall be made in respect of earlier years, for depreciation, "to the extent allowed (but not less than the amount allowable)" under the Act or prior income tax laws. The court below held,

correctly we submit, that depreciation is "allowed" within the meaning of the statute, where claimed by the taxpayer and not opposed by the Commissioner, even though the taxpayer has no net income which is offset thereby. In so holding, the court said (R. 49) there is nothing in the statute, or elsewhere, which justifies restoring to the base the depreciation which has been claimed and allowed in prior returns, merely because such allowance has resulted in no tax benefit. Cf. *Mother Lode Coalition Mines Co.* v. *Helvering,* decided December 7, 1942, No. 94, present Term, not yet officially reported.

Although the instant decision appears to be in conflict with *Pittsburgh Brewing Co.* v. *Commissioner,* 107 F. 2d 155 (C. C. A. 3), as asserted by petitioner (Pet. 5, Br. 10, 13–15), the situation is not one that calls for certiorari, for the existence of a *present* conflict between the two circuits is open to serious question. As indicated by the court below (R. 52), the authority of the *Pittsburgh Brewing Co.* decision has been considerably shaken by a later decision of the same court. *Commissioner* v. *United States & Int. Sec. Corp.,* 130 F. 2d 894. In this subsequent case, the Third Circuit held that amounts recovered in any taxable year upon debts previously charged off and allowed as a deduction should be treated as taxable income regardless of whether the prior allowance of the deduction resulted in a tax benefit to the

taxpayer.[1] In so holding, the court did not mention the *Pittsburgh Brewing Co.* case, but since the two decisions cannot consistently stand together and the later one must be accepted as representing the present views of the court, the *Pittsburgh Brewing* case cannot be regarded as authoritative now in the Third Circuit. Accordingly, in the absence of any present conflict among the circuits, the Court would be justified in denying certiorari.

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[1] The court has granted a rehearing in this case to determine the effect of Section 116 of the Revenue Act of 1942, Public Law 753, 77th Cong., 2d Sess., which provides:

"SEC. 116. RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENCY AMOUNTS.

"(a) *Exclusion From Income.*—Section 22 (b) (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

"'(12) *Recovery of bad debts, prior taxes, and delinquency amounts.*—Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

"'(A) *Definition of Bad Debt.*—The term "bad debt" means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

"'(B) *Definition of Prior Tax.*—The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

"'(C) *Definition of Delinquency Amount.*—The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time re-

The problem has also reached decision in the Seventh Circuit, and the Circuit Court of Appeals for that circuit followed the instant decision (*Commissioner* v. *Kennedy Laundry Co.*, decided

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quired by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

"'(D) *Definition of Recovery Exclusion.*—The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under section 102) or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.'

* * * * * * *

"(b) *Effective Date of Amendments Under the Internal Revenue Code.*—The amendments made by this section shall be applicable with respect to taxable years beginning after December 31, 1938.

"(c) *Under Prior Revenue Acts.*—For the purposes of the Revenue Act of 1938 or any prior revenue Act, the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such revenue Act on the date of its enactment."

The new regulations have not yet been issued.

There is no comparable provision in the 1942 Act with respect to depreciation and in the circumstances it seems clear that the allowance of an exclusion in a case specifically covered by the statute would not require a similar result here. Indeed, we submit that the method of treatment in the 1942 Act indicates that unless otherwise specifically provided, a deduction should be accorded full significance without regard to whether the claimant derived a tax benefit therefrom.

February 15, 1943), reversing the decision of the Board of Tax Appeals (*Kennedy Laundry Co.* v. *Commissioner,* 46 B. T. A. 70) relied on by petitioner (Pet. 5; Br. 10). The problem is now pending in the Ninth Circuit, on appeal from *Don Lee, Inc.* v. *United States,* 42 F. Supp. 884 (N. D. Cal.), also cited by the taxpayer (Pet. 5; Br. 10).

In the circumstances, we submit that there is at present no sufficient reason for the granting of the instant application.

## CONCLUSION

The decision is correct and the petition should be denied.

Respectfully submitted.

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